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How Politics Shaped Modern Banking in Early Modern England

Rethinking the Nature of Representative Democracy, Public Debt, and Modern Banking

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Abstract

The recent sovereign debt crisis raises a debate on whether the cancelation of sovereign debt is compatible with democracy. Scholars opposed to the cancelation of sovereign debt refer to the Glorious Revolution of 1688, in which the British government began to make the people as a whole liable for the obligations incurred by their government. These scholars argue that this commitment formed the basis of the development of the financial system. This paper criticizes this argument by identifying the intrinsic contradictions of representative democracy, public debt, and modern banking in early modern England, contradictions that were incompatible with the well-being and democracy of a community. It further examines how the contradictions of representative democracy and public debt contributed to the evolution of modern banking at the time.

Zusammenfassung

Die aktuelle Staatsschuldenkrise führt zu einer Debatte über die Demokratieverträglichkeit von Staatsschuldenerlassen. Ihre Gegner führen das Beispiel der „Glorious Revolution" von 1688 an, als das britische Volk erstmalig für von seiner Regierung eingegangene Verpflichtungen haftbar gemacht wurde, und sehen in dieser Haftungsverpflichtung die Grundsteinlegung für die Entwicklung des Finanzsystems. Das vorliegende Papier hinterfragt diese These kritisch und legt die intrinsischen Widersprüche repräsentativer Demokratie, öffentlicher Schulden und modernen Bankwesens im frühmodernen England dar, die mit Wohlergehen und Demokratie in einer Gesellschaft nicht vereinbar waren. Das Papier untersucht darüber hinaus, wie die Widersprüche zwischen repräsentativer Demokratie und öffentlichen Schulden seinerzeit zur Entwicklung des modernen Bankwesens beigetragen haben.

Contents

How Politics Shaped Modern Banking in Early Modern England: Rethinking the Nature of Representative Democracy, Public Debt, and Modern Banking

1 Introduction

The recent European public-debt crisis has raised the question whether debt cancelation is compatible with democracy. Scholars in favor of debt cancelation emphasize that democracy began in the ancient city-state of Athens when Solon cancelled the debts of the poor and banned debt bondage in 594 BC (Hudson 2011). In contrast, scholars against debt cancelation emphasize the Glorious Revolution of 1688, in which the British government began to make the people as a whole liable for the obligations incurred by their government (James 2011).

Scholars have examined the relationship between representative democracy and public debt at the dawn of capitalism. Douglass North and Barry Weingast (1989) have argued that the development of representative institutions – the constitutional division of powers and the delegation of power to independent authorities – after the Glorious Revolution enhanced the British government's commitment to repay public debt and improved government access to credit. David Stasavage (2007) has emphasized a different aspect of representative democracy, namely that the development of partisan politics between Whigs and Tories and the dominance of the Whigs after 1715 enhanced the government's commitment and credibility. Peter Dickson (1967) has argued that improved government access to credit formed the basis of the development of financial markets where the stocks of chartered corporations, the banknotes of the Bank of England, bills of exchange, and perpetual annuities issued by the government were traded. Dickson calls this development a 'financial revolution' that formed a national credit economy in late seventeenth-century England.

These scholars' historical research supports the arguments of those who are opposed to the cancelation of public debt. Their reasoning is as follows: to secure a financial system, a government must commit itself to its debt obligations; to meet this commitment, the government must cut public spending and sell off public companies; this commitment thus contributes to political order and the accountability of representative democracy. This reasoning has been challenged, however, by the ongoing series of demonstrations and general strikes in Greece, Spain, and the United States. Those in favor of debt cancelation argue that securing a modern financial system and representative democracy can contradict the well-being and democracy of a community.

Critical scholars refer to the intrinsic contradictions of representative democracy, public debt, and modern banking in early modern England, contradictions that were incompatible with the well-being and democracy of a community. For example, David Graeber (2011) explores how cold-blooded calculation and violence have turned human sociality and mutual connectedness into a creditor-debtor relation, and how this relation has caused great violence to humanity for the last five thousand years. Postmodernists Simon Tormey (2005) and Thomas Catlaw (2009) have argued that representative democracy is a form of class domination used to subsume difference within an imposed identity.[1] Jonathan Nitzan and Shimshon Bichler (2009: 294) argue that public debt is the earliest organized violence made by the capitalist class against society. The Austrian school of economics, including Ludwig von Mises, Friedrich August von Hayek, and Murray Rothbard, has criticized modern banking for fraudulently creating an additional title of wealth out of thin air. In spite of these scattered insights, no critical theory has successfully identified the connectedness of those seemingly unconnected phenomena – the contradictions of representative democracy, public debt, and modern banking.

This paper adopts and extends the normative arguments of the above-mentioned critical scholars. Some readers may find the normative critiques of these scholars to be biased and unpersuasive. Unfortunately, a more in-depth discussion on their normative critiques exceeds the limits of this paper, although such debate can be found in Tormey (2005), Catlaw (2009), Huerta de Soto (2009), Graeber (2011), and Nitzan and Bichler (2009).

This paper asserts that the contradictions of those three phenomena – representative democracy, public debt, and modern banking – evolved together and mutually contributed to the evolution of each other in early modern England. Such mutual connectedness is explained by conceptualizing them under the same notion of "the trust." This conceptualization implies that the three phenomena originated from the same cultural and political motive, even though they look inherently different. Once we successfully examine the mutual connectedness, we can better understand the relationship between democracy and debt cancellation.

The trust has been understood mainly as a distinctive English legal concept. It is a double-ownership concept that makes it possible for two exclusive ownership claims to exist simultaneously over the same asset, namely legal ownership claimed by trustees and equitable ownership claimed by the beneficiaries. Major institutions of capitalist society are also trusts. For example, as John Locke argues, representative democracy is a trust. Moreover, joint-stock arrangements with limited liability in business corporations are trusts (see Table 1). Even imperial powers used the idea of the trust by considering

1 The normative alternative democracy to representative democracy might include Jean Jacques Rousseau's idea of direct democracy and the postmodernists' idea of democratic network society (Catlaw 2009).

Table 1 Double ownership in the three trust schemes

		Trust schemes		
		Modern banking	*Representative democracy*	*Joint-stock company*
Double ownership	*Legal owners*	Bank	The state or the people (represented by congressmen)	Company (represented by managers)
	Equitable owners	Depositors[a]	People	Stockholders

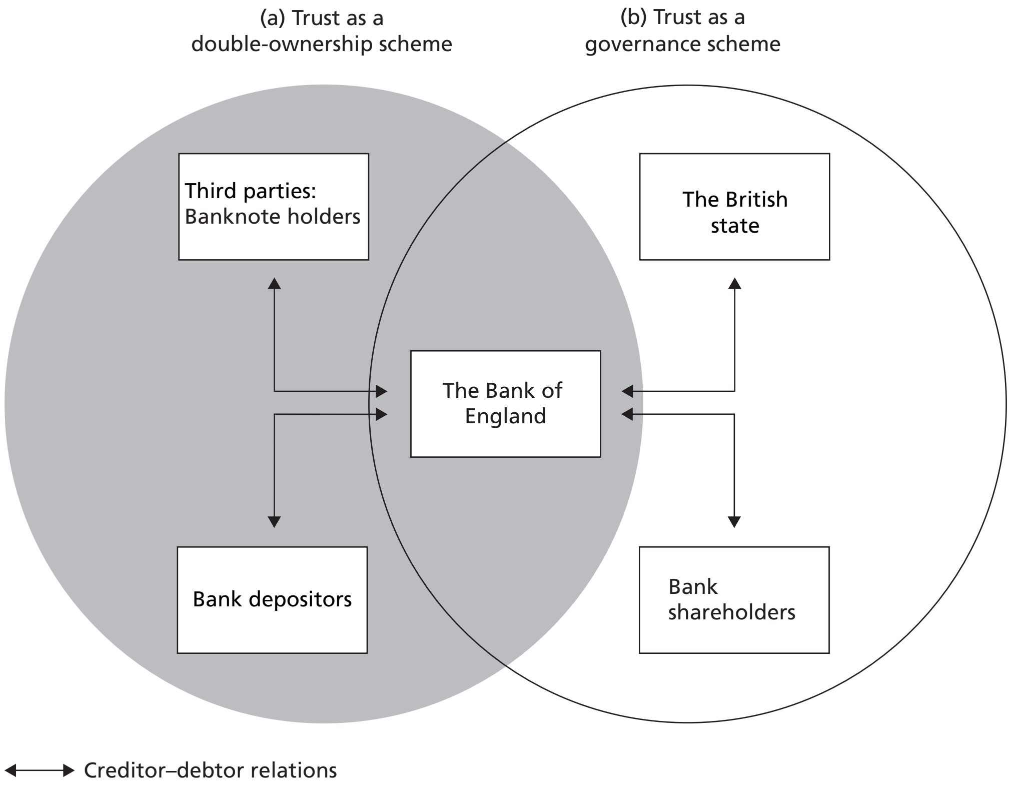
a The deposits of modern commercial banks are not regarded as equity under existing law. But the ownership of the deposits practically remains in the hands of depositors, because the deposits are repaid on demand (see section 2).

themselves the "trustees" of their colonies. In a previous paper (Kim 2011), I argued that the law of trusts and modern banking both originated in the same historical context and with the same motive; further, they were both uniquely English phenomena. Extending this historical research, this paper argues that the first modern joint-stock bank, the Bank of England, grew within the context of the legal and political culture of the trust, specifically, representative democracy and public debt. Thus, arguably, understanding the cultural and political implications of the legal and political culture of the trust is critical to understanding the cultural and political implications of modern banking.

Figure 1 conceptualizes the argument of the paper in a simple form. The argument extends my previous argument that modern banking is a trust (Kim 2011; see [a] in Figure 1). Similar to the double-ownership scheme of a trust, two groups in modern banking – the holders of bankers' notes and bank depositors – are the *exclusive* owners of one and the same cash kept safely in bankers' vaults; and a single quantity of cash creates two cash balances of the same amount, one for the holders and the other for depositors. As a result, demand deposits with commercial banks, together with commercial banknotes – which are issued on the basis of those demand deposits – create money supply. This is a mechanism by which bankers create money out of thin air.

The trust is also a governance mechanism that creates and governs a personified group. A trust makes it possible for the individualistic purposes of property owners to endure permanently beyond a life span, and this permanent endurance is possible because the trust constructs a personified group independent of its constituents. Since the early thirteenth century, and increasingly since the second half of the seventeenth century, the landed class had used the trust – and its feudal form, the *use* of land – as a device to make its interest in property *endure* when endurance was impossible, for example, after

Figure 1 Early modern banking as the combination of two trust schemes



death or due to external interference, especially to evade taxation by the rulers or the state. To avoid all legal responsibilities as an owner, the owner *transfers* legal ownership to trustees but retains equitable ownership. Noticeably, the owner transfers legal ownership to a *group of replaceable* trustees and, in doing so, solves the problem posed by the death of an individual trustee, which can terminate a trusted interest. Here, the group personality of a trust is created by the group of replaceable trustees, who are obligated to promote the will of the settler.[2]

Similarly, joint-stock banking carried out by the Bank of England was a governance mechanism between two personified groups (the Bank and the British state) and the Bank's shareholders (see [b] in Figure 1). Conceptualizing a modern governance mechanism as a trust is not new, because John Locke, around the time of the Glorious Revolution, had already considered representative democracy a trust. Here, I extend his conceptualization in order to demonstrate the close link and the mirror image between modern banking and modern politics and identify how the governance mechanism of the trust scheme ([b] in Figure 1) enabled modern banking ([a] in Figure 1) to be de-

2 In trust settlements, the group personality of the trust is not explicitly stated, but it is implicitly generated through the group of replaceable trustees and by the transferability of beneficiaries' rights.

veloped. I argue that this specific governance mechanism emerged when the relations between a community (or a group) and its individual members took an entirely novel form. Two such novelties are specified: (1) the personification of groups – the modern nation-state and the business corporation – independent of their constituents and (2) the establishment of these personified groups' indebtedness to their constituents. *The combination of those two novelties was the institutionalization of the trust, because the trust is the combination of the personification of group and indebtedness.* In the trust, an independently personified group is constructed, and this personified group becomes permanently indebted to its beneficiaries because it must permanently pay a benefit to them.

This essay is comprised of eight sections. The first is this introduction, the second examines the intrinsic contradictions of modern banking and the third demonstrates that the self-contradictory and untrustworthy modern banking was supported by the English government because it helped the government to collect the public debt needed in order to wage wars. The fourth and fifth sections explore the contradictions of public debt and representative democracy. The sixth section examines the meaning of the credibility of public debt by exploring how the tension – conflict and alliance – between the public state and the private business corporation in the governance mechanism of the trust was critical to determining credibility itself. The seventh section examines how the traditional corporation became a trust-like scheme in early modern England, and the final, eighth section briefly discusses the relationship between democracy and debt cancellation, that is, how the mirror image between the two trust schemes of modern banking and modern politics is the root of the current crisis.

2 Modern banking as a trust and its contradictions

Money creation by private banks finds its origins in the practices of London goldsmiths in the second half of the seventeenth century. The historical event that led to this invention by goldsmiths was the appropriation of cash deposited in the London Mint by Charles I. In 1638, in order to raise funds for a war, Charles I appropriated £200,000 in coin and bullion deposited by London merchants in the Mint. Even though the Crown returned the sum on the condition that the depositors would loan him £40,000, property owners sought alternatives. A number of London goldsmiths offered an alternative safekeeping service by using the trick of double ownership. *They printed additional deposit certificates and loaned them to numerous third parties while still offering depositors the right of withdrawal on demand.* This use of loans for safekeeping was not unique in history. Around the middle of the seventeenth century, bankers in Seville loaned most deposited money to private industry and commerce to escape Charles V's attempt to confiscate the funds remaining in their vaults (Huerta de Soto 2009: 79). But goldsmith-bankers were more innovative: instead of emptying their vaults, they introduced transferable bank notes. This strategy was very successful in "merging" the interests of numerous third parties in the same funds. Creating simultaneous ownership interests among third parties and depositors would make it harder for the Crown to appropriate the funds and would elicit greater opposition when the Crown actually did so.

This double ownership makes modern bank money self-contradictory because it allows the ownership of a thing to be simultaneously *transferred* and *not transferred.* Because deposits in modern banking are repaid on demand, the ownership of deposits practically remains in the hands of depositors. Yet, at the same time, bankers lend deposits at their own discretion and in their own names, and they attain and retain the ownership title to the loans. Here the ownership of deposits is transferred from depositors to bankers because a person can lend property in his or her name only when he or she has ownership of it.

Under the Continental Roman and civil law traditions, "rights *in rem*" are so strictly divided from "rights *in personam*" that the contradictory nature of bank deposits has long been an embarrassing enigma to Continental legal theorists. In these traditions, the rights of a depositor are "rights *in rem,*" rights against a thing, because the depositor retains legal ownership over the deposited property. A depositary should keep deposits safe and honor depositors' requests to withdraw deposits at any time on demand, and depositors are charged a safekeeping fee. In a loan transaction, in contrast, the rights of a creditor are rights against a person, "rights *in personam.*" The creditor cedes legal ownership of property to a debtor during a specified period and, in exchange, obtains a debt claim that goes against a person. The creditor can oblige the debtor to fulfill an obligation to repay the principal and interest. Historically, there has been a long moral and legal debate as to whether depositaries' attempts to utilize deposited funds for their profit constitute a crime. It was considered embezzlement in the Roman law tradition, which strictly separated loan contracts and deposit contracts. In this tradition, an honest depositary of fungible things, such as money and grain, had to keep 100 percent *tantundem* of deposits. This rule existed even in the common law tradition. During the 1860s in the United States, grain elevators issued deposit receipts larger than the amount they kept, and they lent the receipts to speculators in the Chicago wheat market. Resultant swings in wheat prices and bankruptcies in the wheat market were settled when the over-issue was treated as fraudulent and illegal by common law courts (Rothbard, 1994: 38). An exception was made, however, in the common law with regards to demand deposits with banks. In 1848, in *Foley v. Hill and Others,* the House of Lords finally declared demand deposits with banks to be loans to the bankers. Here, bankers were *legally allowed* to issue additional deposit receipts of a value greater than the amount they kept.

The Bank of Amsterdam, a highly respected Continental public bank during the seventeenth century, was established to abolish the contradiction, that is, to clearly distinguish loan-making and deposit-taking; and thus it maintained a 100-percent reserve ratio for over 150 years after its foundation in 1609 (Huerta de Soto 2009: 99). Even with a full reserve, the bank supported trades. Merchants in Amsterdam were legally obliged to present their bills of exchange to the Bank of Amsterdam, where the debts of the bills were cleared among merchants (Richards 1965). The financial role of public-deposit banks on the Continent was to *clear* the creditor-debtor relations created by bills of exchange,[3] while modern banking *extends* creditor-debtor relations. When modern banks issue additional deposit certificates, they do so by loaning them to third parties. Thus, these third parties become debtors to the banks. At the same time, these banks become the debtors of those third parties because the banks maintain only a fractional reserve. Thus, the more money that is created, the more that banks and people become mutually indebted. This spread of creditor-debtor relations was unprecedented because these relations had previously been confined largely to the network of merchants.

This mutual indebtedness turns private bankers into big debtors. Because their debtors do not all withdraw their money simultaneously, a portion of the debts remains in the hands of the bankers and is transformed into permanent capital that they use for profitable long-term investment. For example, prominent goldsmith-bankers, such as Alderman Blackwell, earned record profits from their investments in the Crown. Long-term investment in the Crown was the only exception to the usury law that prohibited interest rates above five or six percent: prominent bankers charged an interest rate of ten percent or even more on loans to the Crown. This is the history of the birth of big debtors, as well as the history of the indebtedness of society to these big debtors.

The Austrian school of economics (Huerta de Soto 2009) argues that modern banking is fraudulent due to its self-contradictory nature: when depositors allow a bank to loan their deposits to third parties, they have, in fact, contracted to create additional titles and claims to the same existing quantity of property. According to this line of argument, what the bankers supposedly offer to third parties is "ready cash" – the present availability and ownership of deposited cash. However, due to a fractional reserve, what the bankers effectively offer is merely credit, a fraudulent creation of additional titles and claims (see Huerta de Soto 2009 for details).[4]

This creation of contradiction and hybridity – credit money – exposes a community to a new form of risk that did not exist in the traditional safekeeping business: the risk of illiquidity in the form of bank runs and other types of liquidity crunches. Such risk

3 The bills are credit instruments, and they differ from modern bank money because their creditors transfer the present availability of a fund to debtors. For a detailed explanation of the difference between bills of exchange and modern bank money, see Kim (2011: 942–945). There I argued that there are five differences in the creditor-debtor relations of modern bank money and bills of exchange: (1) the number of debtors, (2) finality, (3) the distance between original debtors and transferees, (4) demandability, and (5) the expansion of credit.

4 The school does not argue that modern banking is fraudulent under existing law. The law legalizes what was considered illegal in traditional Roman and civil laws by regarding modern bank-deposits as loans (see previous discussion on *Foley v. Hill and Others*). The school argues that modern banking is fraudulent in the sense that it creates additional deposit certificates, i.e., additional titles and claims from one and the same amount of property.

is similar to the risk in a "pass the parcel" game, in which "the loser is the one holding the parcel when the music stops" (Horsefield 1977: 124–125). When depositors suddenly realize that the banks' loaning to third parties is failing and has placed the banks at risk, the depositors initiate a run on the banks in order not to be left holding the parcel. When modern banking creates economic recessions, it generates high costs for third parties who are innocently involved in the transactions of bankers' paper money – including workers, suppliers, consumers, and peripheral countries (Huerta de Soto 2009). Developed countries have devised various means of maintaining this vulnerable, fraudulent[5] modern banking system, especially by establishing a central bank as a lender of last resort and by creating deposit insurance (ibid.). When a financial crisis occurs, private banks ask their governments for bailouts at taxpayers' expense. As soon as taxpayers' money is used for bailouts, the fictionally created money of the banks becomes real money, cash.

3 Modern banking as a means of extracting war resources

As mentioned earlier, goldsmith-bankers were supposed to embed the interests of numerous third parties in the same fund in order to safeguard the fund. To this end, paper money had to circulate widely beyond the circle of the bankers' depositors. Goldsmith-bankers achieved the widespread circulation of paper money in the late seventeenth century, and the Bank of England subsequently pushed their enterprise even further. However, the bank monies issued by both goldsmith-bankers and the Bank of England in early modern England were unreliable – in the first case due to the goldsmith-bankers' frequent insolvency and bank runs, and in the second case due to the Bank's series of suspensions of specie payment. For example, in May 1696, the Bank suspended specie payment and only resumed it two years later. Immediately after the suspension, its notes depreciated severely: according to Rothbard (2008: 180), they promptly fell to a 20-percent discount against specie. The rest of the early history of the Bank was full of periodic specie suspensions and bank runs, such as in 1720 with the crash following the "South Sea Bubble" and in 1745 with the rise of Bonnie Prince Charlie in Scotland. This raises the question: how could bankers' unreliable paper money have circulated widely among a public that did indeed perceive it as untrustworthy?[6]

In short, paper money could circulate widely because the English state supported modern banking in order to use it as a way of extracting war resources. War-making by sovereign kings in the seventeenth century created an urgent need for funds. Around the time of the Glorious Revolution of 1688, the English state's foreign policy was im-

5 See (Huerto de Soto 2009) and footnote 5.

6 The goldsmith-bankers' low fractional reserve – 10 per cent – further accentuated the impression that they were untrustworthy (Horsefield 1977: 122).

perialist, eager to expand colonies and trading advantages. A major barrier to this imperialist policy was France. The huge accumulation of short-term debt – almost £6 million – after the Revolution threatened to overwhelm the government's credit system (Carruthers 1996: 73). To fund wars against France after the Glorious Revolution, Parliament needed to move in the direction of long-term borrowing that did not require quick repayment. This need was satisfied by the proposal offered by some financiers and a City group in 1693 to institute permanent loans (Clapham 1958: 15). These individuals proposed to *incorporate public debt.* The Crown organized a group of its creditors into corporations – for example, the Bank of England (1694), the New East India Company (1698), the United East India Company (1708), and the South Sea Company (1710). The loans to the state were *securitized* into these companies' stocks: the loans were pooled into these companies, and in turn these companies sold claims on the pool to investors in the form of shares. This securitization allowed the state to use the loans permanently without repaying the principal as long as the companies remained incorporated. In return for permanent loans to the state, the Bank was granted the right to create paper money and to have this money accepted in payment of taxes. Because citizens who had tax obligations to the state could use the Bank's private money in settling these obligations, they accepted the money as a means of payment.[7] Furthermore, "in 1697 forgery of the Bank's notes was to be punished with death, the penalty for clipping or coining the King's money." *From then on, the deal between the Bank and the state became the central node in the history of modern paper money* until the Bank of England was nationalized in the twentieth century. In 1833, the English state made this paper money legal tender. This forced the public to accept the private banker's money: private paper money, if it was legal tender, *had to be* accepted by a creditor when it was offered to him or her in payment of a debt. The Bank's notes were not the King's money but private money, because they were a promise to pay issued by the *privately owned* Bank of England. "But they were getting near to [King's money]": they were public currency (Clapham 1958: 50). This use of private bankers' money as public currency constituted one of the essential elements of modernity because previously it had been believed that the power to create money belonged to God or his representative, the King, rather than to private persons.

However, this privilege of the Bank's money was realized, as shall be seen, through the ongoing struggle and compromise between the bourgeoisie and the state. In spite of the the proposal from financiers to offer a permanent loan, the government incorporated the Bank initially for only eleven years and required the renewal of its charter to extend its incorporation.

7 Goldsmith-bankers made their notes acceptable in payment of taxes. This achievement looks mysterious at first because, during the late seventeenth century, the Tellers of the Exchequer, the cashiers of the English government, accepted only specie in payment of taxes. A prominent goldsmith-banker among the first generation of goldsmith-bankers, Edward Backwell, contrived a detour. Backwell made his bank notes acceptable in payment of taxes by forging a private connection with Richard Mounteney, a tax receiver and Cashier of the Customs Revenue for the Port of London. For a detailed discussion, see Quinn 1994.

Had the state not been continuously engaged in war, the Bank may have been abolished in its early days. Had the state no longer needed to collect long-term public debt, it would have no longer granted bankers and financiers the privileges of money creation and chartered incorporation. Parliament, especially MPs representing landed interests, were hostile to the moneyed interest of bankers and financiers that emerged in the latter half of the seventeenth century. MPs often depicted bankers as "upstarts who had been born in relative poverty but now flaunted their wealth" or referred to them as usurers. MPs reproached bankers for plunging the landed class into a permanent depression in the late seventeenth and early eighteenth centuries (Jones 2001: 71–72). During the several decades that followed the Glorious Revolution, the tension between the two interests – the landed interests that dominated Parliament well into the nineteenth century and the moneyed interests that were the government's major creditors – became one of the central themes of English society (Carruthers 1996: 202).

Public debt was war money. According to M. Mann (1986: 485–486), British government expenditures between 1700 and 1815, most of which were funded by public debt, grew fifteen fold. This unprecedented rate of increase was due primarily to a large rise in military expenditures. Bowen argues that:

> Between 1688 and 1815, England or Britain was involved in seven extended wars … It was this continuing element more than any other single factor that defined the Bank's term of reference and the scope of its different forms of banking activity. This meant that public finance and the institutional mechanisms designed to service the spiralling national debt were forged in an atmosphere of ongoing conflict and crisis. (Bowen 1995: 5)

We may speculate that, without the recurrent wars and war-related crises of the eighteenth century that generated the government's urgent need of funds, the hostility of Parliament to bankers might have led to the abolition of the Bank early in its existence. In 1702, a strong section of the Tory Party opposed the renewal of the Bank's charter and claimed that large-scale Continental campaigns only served the selfish interests of sectional groups and financiers by binding Englishmen to large and long-term debt obligations. This group of Tories insisted that England should first concentrate on naval and colonial campaigns and that the wars could then be financed exclusively by taxes and limited short-term borrowing (Jones 2001: 84–85). Without English involvement in large-scale Continental wars, this Tory policy would have been realized.

The Bank of England began as a makeshift project to support the state temporarily during the war against France, and initially few, if any, expected its huge success in mobilizing resources for large-scale wars. However, the financial revolution triggered by improved government access to credit allowed England to defeat France and emerge as a dominant power in the West by the late eighteenth century (Dickson 1967). This unexpected success made the Bank an indispensable long-term project for modern England. This explains why English banking, rather than Continental public banking, became the dominant form of modern banking. Because English banking played a role as the provider and administrator of public debt, it became an effective means of providing war resources to the state. In contrast, the Continental public-deposit banks at that time were forbidden to provide loans not only to private parties but also to the public sector.[8]

4 Public debt and its contradictions

Public debt – a state's indebtedness to its citizens or groups of citizens – is a modern and Western European phenomenon. It existed in neither ancient Greece nor Rome (Hamilton 1947: 118). Historically, the converse of public debt, the indebtedness of social members to a community, seems to have been common. Traditionally, sovereign kings did not tolerate being indebted to their subjects because this indebtedness contradicted their supreme authority over their subjects. Medieval English monarchs thus borrowed money from foreign bankers, such as Sienese and Florentine bankers, rather than from their subjects. The medieval monarchs of other countries in the West did the same.

Public debt has intrinsic problems. First, public debt defines the relationship between a community and its members as a creditor-debtor relation, that is, it considers a citizen's contribution to a community to be the debt that the community must repay in the future. This is an extreme case of individualism.

Second, public debt requires the state to be more than a simple collective. Instead, the state and its members must be treated as separate persons, since only separate persons can make debt contracts with one another. Public debt is incurred when a state becomes indebted to its subjects and when the responsibility for repaying this debt lies on the state itself rather than on each individual subject. In the term "public debt," argues Frederic Maitland (1911), the "public" is not so much a sum of individuals as a personified group separated from the personalities of individual members (how this separation happened is explained later in this section).[9]

8 In this and subsequent sections, we discuss early modern banking, focusing on the development of the Bank of England. Even though the Bank was, until the 1826 Bank Act, the only joint-stock bank, country banks that issued their notes with a fractional reserve increased rapidly in the second half of the eighteenth century and numbered more than 780 by 1820 (Richards 1965: 193). Our focus on the Bank of England is justified, however, because the development of the Bank's money served as a base for the English national banking system at that time: those private country banks "increasingly used Bank of England notes as reserves and pyramided their own notes on top of them" (Rothbard 2008: 182).

9 Since its creation, public debt has often been owed to foreign entities. Even in this case, the state is separated from its citizens' personality, and the responsibility for repaying the debt lies with the state itself rather than with each individual subject.

To ascribe to an organized group, such as the state or a business corporation, a personality distinct from that of its constituents' personalities is ontologically absurd. This distinct personality makes the whole a part that is treated the same as other constituent parts. However, the whole cannot simultaneously be a part of the whole. Imagine, for example, a state that consists of ten people. How many persons exist in the state? Ten. If the state is indebted to its ten citizens and if only the state is required to repay that debt, which remains separate from the obligations of the ten citizens, the state obtains its own personality distinct from that of its citizens. Now how many persons exist *in the state?* Eleven! The personified group is now the whole and, at the same time, a part of the whole. This ontological absurdity became reality in early modern England.[10] An intriguing fact of the capitalist economy is that this ontological absurdity has become reality.

To be a person or to have personality here means to be the abstract subject capable of nothing but claiming property or bearing obligations to repay debt. This conception of person as the abstract subject prevailed in early modern England. For example, in Locke's theory of person and property, which provided the ideological foundation for the Glorious Revolution, all the attributes of a person, including labor, body, and liberty, are property that the person can own and transfer to other persons. What remains, after having turned all the attributes of a person into property owned by that person, is the abstract subject that retains its identity as the owner of property. These ideas of property and person contributed to the generation of the modern ideology of human equality. Property – attributes and things – make human beings different from each other. By considering human beings separate from their property, however, modern English law treats them *as the same and equal to each other.* To this peculiar idea of person, the trust adds a new dimension: it creates, as shall be seen, the personality of an organized group (the state, the people, or the business corporation), a personality distinct from that of its constituents' personalities.

The independent personality of the state can be regarded as growing out of traditional body politics. The political relationship between the sovereign and its subjects in England has been instituted since medieval times as the relationship between two corporate actors – the Crown, as a corporation, and civil corporations. Since medieval times, various sectors of the population had been organized into corporations. Cities and boroughs, guilds, universities and colleges, hospitals and other charities, bishops, deans, chapters, abbots, and convents and other ecclesiastical bodies were corporate persons. In relation to these permanent corporate persons, the Crown, too, was a corporation. A specific king or queen in succession was regarded a member of *the Crown as a corporation.* A corporation having a single member at a given time was called a *corporation*

10 Acknowledging the contradictorily dual nature of the modern state, legal theorist W. Friedmann writes: "Every modern 'Rechtsstaat' is faced with [the] problem of keeping distinct the State in its dual aspects as 'Staat' and 'Fiscus,' as exercising authority over its citizens and as subject of private rights and duties, side by side with other legal personalities" (1937: 93).

sole, in contrast to a *corporation aggregate,* which was comprised of many members. This relationship between two personified groups, the Crown as a corporation and civil corporations, was called the body politic. When the English state organized a group of its creditors into the Bank of England in 1694, it continued the traditional governing method of organizing a group of its subjects into a corporation.[11]

The incorporation of the Bank had, however, a novel element: *the state began to involve itself in permanent creditor-debtor relations with the corporate persons* into which its subjects were incorporated. We conceptualize this as the combination of the personification of group and indebtedness, meaning, the trust.

The corporate state's permanent indebtedness to its constituents should be understood as a result of the political struggle in seventeenth-century England that revolved around the following question: "Who is the sovereign that imposes tax and is responsible for sovereign debt?" The Glorious Revolution resolved the question by creating a new personality of the state, that is, *the* people – an entity that is sovereign over the Crown and Parliament and is responsible for public debt. Governments were not sovereigns but mere representatives of the interest of the people. Sovereign debt was no longer the debt of the Crown, but public debt, the debt of *the* people. This innovation increased the government's credibility in regards to its debt obligations. Previously, sovereign debt had been the personal debt of kings and thus went bad when kings died, and their royal privilege easily led them to repudiate their debt obligations. For example, Florentine bankers Bardi and Peruzzi went bankrupt when Edward III repudiated his war debts in 1345. In 1672, Charles II defaulted on the money that goldsmith-bankers had loaned him. This default, called the Stop of the Exchequer, resulted in the failure of many London goldsmith-bankers and made their notes unacceptable during the 1670s. However, after the Revolution, the people became liable for the debt obligations of the government regardless of who the king was. This political change enhanced the government's commitment to and credibility in being able to repay its debt and thus became the basis for the development of the financial system in early modern England.

Public debt first appeared in the medieval Italian city-state of Venice in the twelfth century, and later in Genoa and Florence. Because public debt presupposed the corporate personality of the state, there was an important development in political theory: for the first time in history, there emerged the modern conception of the state. During the thirteenth and fourteenth centuries, commentators on Roman law in Italian city-states, especially Bartolus and Baldus, regarded the state as an abstract entity, distinct from its government and its members (Canning 1983: 23–24).

11 See closing paragraphs in section 6 for the difference between the trust and traditional corporations.

However, the indebtedness of Italian corporate city-states to their citizens was not public debt in the strictly modern sense, because the rights and responsibilities of a republic and its citizens were not fully separate. When a republic could not repay its debt, its creditors could claim repayment against a few of its wealthy citizens. The republic often forced its citizens to buy public debts. England was the first to fully develop the separate group personality of the state. Private property rights, which had been developed since the Middle Ages and were settled by the Bill of Rights after the Glorious Revolution, prevented the state's creditors from claiming repayment against individual citizens and thus assigned the debt obligation to the state itself.

5 Representation and its contradictions

Representative democratic government contributed to the origins of public debt in two ways. First, it created the group personality of the state independent of the rulers and the ruled. Second, it contributed to the conceptualization of the state as a moral debtor.

As Hobbes and Locke argued, representation makes the impossible possible. A state cannot achieve unity or uniformity because its constituents – people – are diverse. However, representation leads people to entrust their interest and liberty (by elections or other voluntary ways) to a king or parliament. Representation thus makes unity or uniformity possible in one body, whether that of a king or parliament. People are numerous and diverse, but a king or a parliament is a singular or small body that can achieve unity more easily (Locke [1690]1988, §212). In such a way, representation transforms diversity into unity, and *people* into *the people.* Here, the interest of the people that representative government puts into practice is not the interest of the majority of people; it is the interest of the people distinct from the interests of people (Runciman 1997).

Tracing the semantic development of the term *representation* helps us understand how representation creates group personality. The verb *repraesentare* in Latin originally implied that "something absent is being re-presented to the gaze" (Skinner 2005: 160). For example, representation refers to the asserted magical potency of aesthetic acts. A successful painting or sculpture, according to this understanding, does more than produce resemblance; it re-presents actual things or persons so that someone who sees the work of art will believe that he is seeing the things themselves and not merely their resemblance (ibid.: 160–161).

From about the fourth century of the Christian era, the terms *repraesentare* and *repraesentatio* were extended to include references to speaking or acting in the name of someone else (ibid.: 161). Here representation revolved around the term *persona,* from which the English term *person* originated. The public role of magistrates was to re-present or bear the personage of the city (ibid.: 162). In England, Elizabeth I as a public person was considered to represent the personality of the English state. This idea of re-presenting group personality in a public person prevailed in Protestantism. "The idea that Adam and Jesus Christ are representatives of the whole of mankind was adopted by a large number of Protestants from Luther onwards, though the phrase is not Biblical in any of its variations" (Hill 1986: 300). An English innovation was to adapt this idea of representation to democratic ideology. The radical propagandists of the 1640s began to claim that Parliament represents the people.

This doctrine had a serious flaw, however, and this problem was solved by the idea of the trust. As Hobbes and Locke correctly claimed at the time, a collective consisting of the diverse interests of people cannot be considered *a* person who has one interest, and thus there is no pre-existing personality or identity of the people that parliament can represent. Hobbes and Locke thus argued that representation creates the personality of the people when each individual citizen *entrusts* his liberty and power to rule himself to a king or parliament; and by this *trust*, a unity or uniformity becomes possible in one body, whether that of the king or parliament (Hobbes 1651, chap. 16 §13; Locke, [1690]1988, §212).

This trust added a new characteristic – a creditor-debtor relation – to the relationship between representatives and people and, by doing so, contributed to conceptualizing the state as a moral debtor. According to the modern doctrine of public trust, a small group of representatives *brings about* the interest of the people, and the power of trustees to govern people according to this interest is supreme. Unless this created interest betrays the good of the people, the people cannot overthrow a representative government (Goodhart 1948: 677–678). However, the power is entrusted by – or *borrowed* from – people. Public trustees have been charged with a moral and legal obligation to exclude their own interest and promote the purpose of the people. As a result, under the doctrine, the power to rule people is a hybrid. On the one hand, it is trustees' property because the body of the trustees brings about the united interest of the state. On the other, it is borrowed power. It is in the doctrine of the public trust that the two ideas of *group personality* – the creation of the interest of the people – and *indebtedness* – the borrowing of power from people – converge.

The doctrine contributed to enhancing the government's commitment to the repayment of public debt. The creditors of public debtors pressed the state to honor its debt obligations, and this pressure caused the state to undertake administrative reforms in the late eighteenth century. For example, the *Reports of the Commissioners for Examining the Public Accounts (1780-7)* are considered to have brought about one of the significant administrative reforms of the English government to improve the transparency and accountability of the government. In these reports, the doctrine of the trust is used as a central argument in favor of the administrative reform (Torrance 1978).

Postmodernists have criticized the idea of representation. Their main criticisms are, first, that *the people* and the interest of the people do not really exist because people are diverse in reality; second, that the creation of an imaginary entity of the people is anti-democratic; and third, that representative politics comes from the desire to reduce diversity and creativity to sameness. As postmodernist G. Tormey (2006: 144) argues, "'What The People want', is not what *people* want, but rather what it is that someone thinks the people want. It is what the 'representatives' of The People's interests want." This construction of the interest of the people is a means for the representative to proclaim class interest as universal interest.

Just as the creation of the people is ontologically absurd (see 4th paragraph of section 4), so too is the idea of the trust, specifically, that an individual's liberty and power to rule herself can be *transferred* to third parties. This idea of the separability and transferability of human attributes comes from the peculiar modern concept of property. Again, in this concept, especially as presented by Locke, all the attributes of a person, including labor, body, and liberty, are property that the person can own and transfer to other persons.

6 Credibility? Is it improved simply by being committed to paying debts?

When we include the governmental mechanism of modern banking under the trust, we can better understand the meaning of credibility. As mentioned earlier, economic historians emphasize that the government's commitment to repay public debt improved the government's credibility in early modern England. However, the improvement of credibility cannot be explained simply by the commitment to repayment. Rather, we find that the government's threats toward creditors are what improved its credibility. Here we examine how the political nature of credibility evolved around the politics of the trust. To reiterate an earlier point, the trust has two owners, one legal and the other equitable. The conflict and compromise between these two owners or two different ruling classes have been a central aspect in the development of the trust since the Middle Ages (Neale 1975). In this section, we explore how the tension – conflict and alliance – between the public state and the private business corporation in the governance mechanism of the trust was critical to determining credibility.

Public confidence in the paper money and shares of the Bank depended on the Treasury's ability to pay interest regularly and the honoring of this obligation by all future administrations. The huge accumulation of long-term public debts, however, would make it difficult for future administrations to honor this obligation without restructuring previous public debts, the conditions of which, such as interest rates, redeemability, and maturities, were not advantageous to the state. The Bank at its inception was intended to be a temporary institution, and the state could dissolve the Bank with one year's notice at the end of the contracted lifespan. Initially, too, the Bank's privilege of issuing paper money was not monopolistic. Parliament could grant this privilege to other chartered companies at any time. Furthermore, the Bank's paper money was not yet legal tender. Both the improvement of the fiscal capability of the state and the strengthening of the Bank's joint-stock banking privilege were a result of the struggle and resultant compromise between the Bank and the state during the next century.

Parliament considered the privileges of the Bank of England to be "the estate of the public trusted to the government" and sought to insure that the sale of this public estate had been properly compensated. The Bank was rechartered nine times between 1694 and 1844. Every time rechartering came up, ministers or Parliament threatened, latently or overtly, to review the statutory arrangements for the Bank's operation. They threatened, for example, to dissolve the Bank's incorporation or to establish other competing banks (Bowen 1995: 17). In 1696, Parliament did indeed authorize the incorporation of the Land Bank to serve the landed interest and thereby intended to create a competitor to the moneyed interest of the Bank of England. Even though the Land Bank failed instantly, this challenge prompted the Bank of England to negotiate the recharter of 1697. This negotiation extended both the fiscal capability of the state and the privilege of the Bank of England. The government was offered additional loans, and, in return, the 1697 Continuation Act proclaimed that "no other Bank or Constitution in the nature of a bank be erected or established, permitted or allowed by Act of Parliament during the Continuation of the Bank of England" (Clapham 1958: 47). However, in spite of such a proclamation, the state remained omnipotent in constitutional theory: another statute could have been enacted at any time to suspend what had been contracted (Jones 2001: 83). In other words, Parliament could have set up another competing bank even after the 1679 Continuation Act. In fact, a little more than a century later, in 1800, the Bank had to negotiate an early recharter because of parliamentary pressure to establish a rival public bank (Bowen 1995: 8–9).[12]

These latent or overt threats were effective in reducing the interest rate on government long-term debts. In 1750, the state wanted to reduce the interest rate for £57.7 million in long-term debt (72 percent of the national debt). At that time, 27 percent of this debt was held directly by three companies the Bank of England, the South Sea Company, and the East India Company and almost all the rest was administered by the first two of these companies (Quinn 2008: 31). Because this interest-rate reduction posed no benefits to creditors and the companies, the companies turned down the state's request, and most individual creditors followed suit. Just one month later, the state threatened to curtail the Bank's privileges, and the Bank reversed its decision, with individual credi-

12 The Bank additionally loaned the government £400,000 without interest in the recharter of 1708, £1.6 million without interest in the recharter of 1742, £1 million on Exchequer Bills for two years at 3 per cent in the recharter of 1764, £2 million at 3 per cent for three years in the recharter of 1781, and £3 million without interest for six years in the recharter of 1800. In the recharter of 1764, the Bank paid a fee of £110,000 for its privileges (Broz 2004: 51–52).

tors rushing to follow (Sutherland 1946: 28). By threatening the Bank's privileges, the state succeeded in restructuring previous public debts and improving its ability to honor its debt obligation.

The above mentioned concessions of the Bank to the state came with the reassertion of the Bank's privileges. For example, in the recharter of 1708, when the Bank offered an interest-free loan of £400,000 to the state, it became illegal for any group exceeding six persons, except the Bank, to issue notes or bills payable at demand. As a result, goldsmith-bankers were no longer serious rivals to the Bank.

The corporate ownership of British public debt held by the Bank of England, the East India Company, and the South Sea Company rose to eighty percent by 1720 and then slowly declined to twenty percent in the late 1750s (Quinn 2008: 2–3). In spite of this decline, joint-stock politics remained an important tool for restructuring public debt because the Bank's role as an administrator of public debt continued. The Bank has not been rechartered since the Continuation Act of 1844. Beginning around the middle of the eighteenth century, the distinction between landed and financial interests became blurred as the landed class effectively extended its investment into intangible property, such as governmental and commercial stocks and debentures, along with other forms of transposable goods (Jones 2001: 90; Chesterman 1984). However, joint-stock politics, which maintained the tension between the state and business corporations, remained an important governmental tool in nineteenth-century England (Alborn 1998).

7 The corporation and trusts

Modern business corporations have also become a trust-like scheme. Incorporation is generally understood to create a group identity. In traditional corporations, however, the personality of the group was not clearly separated from the identities of its constituents. As G. Simmel ([1896]1991: 18) writes,

> The medieval guild included the entire person; a weavers' guild was not an association of individuals that only pursued the mere interests of weaving. Instead, it was a living community in occupational, social, religious, political and many other respects … [I]ts members … were absorbed in it without rights of their own.

Peculiar to the evolution of separate group identity in England, the trust was a more popular scheme for group identity. With the Bubble Act 1720, the English state forbade all corporate forms of joint-stock companies that were not authorized by statute. However, until general incorporation was made possible by statute in the nineteenth century, trust schemes were widely used to create joint-stock companies. Corporations were traditionally a governing tool of the state to regulate civil activities such as trade. Thus, the group personality of corporations was granted, from the top down, by the Crown. In contrast, trusts were a tool for individual freedom to avoid the interference of the state, and they were organized autonomously, from the bottom up, by private property owners themselves. Thus, the group personality of the Bank was a hybrid between a trust and a corporation. It had to be chartered by the Crown but, at the same time, depended upon the limited liability and transferability of its ownership. When the Companies Act of 1862 permitted the establishment of business corporations without a charter from the state, the traditional form of corporation was transformed into a trust-like scheme.

The first joint-stock company, the Dutch East India Company, emerged in the Netherlands in 1602. When the company borrowed money from its constituents – its stockholders – in the name of the company, it could be regarded as a person possessing an identity distinct from the identities of its constituents. However, the independent personality was not fully formed in the strictly modern sense because the rights and responsibilities of the company and its constituents were not fully separate. The stockholders were less the owners of the company than its creditors. The stockholders could not control the company's business, because the directors of the company were elected by city councils, not by its shareholders (Neal 2005). We can thus regard the separation of the rights and responsibilities of the company and its stockholders as the traditional separation between debtors – the company – and creditors – third parties – rather than between the company and its constituents. In contrast, the stockholders of the Bank of England were owners and thus had the right to vote to select directors and decide important managerial issues; and the directors were responsible only to the stockholders. At the same time, the stockholders had limited liability. Due to this limited liability, the responsibilities of the Bank became separated from those of its constituents. The personality of a business group, understood in the strictly modern sense, was first formed in England.

8 Conclusion

In the twentieth and twenty-first centuries, the United States seems to have extended the scheme of the trust internationally. U.S. public debt remains a war debt that feeds American military predominance, because the United States would not run a deficit at all without huge military spending (Graeber 2011: 365). A main difference from the trust scheme of early modern England is that the main creditors of U.S. public debt are those countries that have been under U.S. military occupation, such as West Germany, Saudi Arabia, Japan, Taiwan, and South Korea. The American government is the biggest debtor and benefits from its permanent indebtedness. Because creditors do not all demand repayment simultaneously, a portion of the debt remains permanently in the hands of the American government. This portion is transformed into this debtor's capital, which feeds American military predominance. As the Treasury bonds purchased by creditor countries depreciate in value, these countries are in effect paying tribute or seigniorage to the United States (ibid.: 367). U.S. military dominance over, and foreign policy towards those foreign countries have been critical to maintaining permanent American indebtedness. Furthermore, even though the equitable owners of American public debt are foreign countries, American corporations have legally owned about half of U.S. public debt since the Second World War. The political alliance between these corporations and the American government also remains critical to maintaining permanent U.S. indebtedness.

This description is oversimplified, of course, but helpful in order to discuss the relationship between democracy and debt cancellation.

The global financial crisis of 2008 began as a banking crisis in the United States. To stabilize their financial systems, governments in the EU and the United States provided large bailout packages to their financial sectors, and these bailouts turned private banks' debts into taxpayers' obligations: public debt. In the American case, $13 trillion has been added to its public debt since September 2008 (Hudson 2011). Due to similar bailout packages and the subsequent global economic slowdown, the average fiscal deficit in the EU grew to 7 percent during the financial crisis, from only 0.6 percent in 2007 before the crisis (Économistes Atterrés 2011). The United States has the political and military power to control its creditors and can thus permanently roll over its public debts, but some European countries without such power are in trouble for rolling over theirs.

Douglass North received the Nobel Prize in 1993 for his research demonstrating that the British government's commitment to repay public debt after the Glorious Revolution contributed to economic growth. His historical research has often been used as a theoretical justification when First World countries force the government of a Third World country to bail out its private banks and to repay their debts to the banks of creditor countries. It is argued that this commitment to repayment will improve the credibility and stability of its national financial system and contribute to improved economic growth in the long term, even if this debtor country needs to adopt austerity policies in order to make the repayment.

This paper challenges this reasoning. First, we have critically discussed the nature of modern banking. What the banks from First World countries supposedly offer to the private banks of the Third World country is cash. But due to the fractional-reserve system, what the banks effectively offer is merely credit, a mere additional creation of titles and claims from one and the same amount of property. This creation conflicts with the foundation of liberal democracy – the principle of property. According to this principle, it is deceptive for someone to create additional deposit-certificates, that is, additional titles and claims on one and the same amount of property. The risk of its debtor's bankruptcy is what a creditor must endure in return for earning interest on its loan. Furthermore, modern banking extends creditor-debtor relations to society as whole, relations whose cold-blooded calculation and violence have done great harm to humanity for the last 5,000 years (Graeber 2011). It exposes a community to the risk of illiquidity in the form of bank runs and other types of liquidity crunches and originated as a means to mobilize resources for large-scale wars.[13] In the current international system based on the modern idea of the state, the people as a whole in a Third World country have been made liable for the obligations incurred by their, often despotic, governments. This system unduly secures creditors' rights at the expense of debtors and resultantly promotes both the evolution of modern banking and the spread of creditor-debtor relations. Why must people suffer in order to improve the credibility and stability of such a morally and politically corrupt banking system?

Second, we have discussed the nature of public debt and representative democracy. These two developments helped form the alliance between politics and big business corporations, and this alliance contributed to the development of modern banking. Originally, public debt was war debt, and it remained so in twentieth-century America. Representation is a means for representatives and their allies (big business corporations) to proclaim their "class interest as the universal interest" by creating the independent personality of the people. Due to the large bailout package to the financial sector, private banks' debts are turned into taxpayers' obligations: public debt. Both representative democracy and public debt make a society as a whole liable for the debt obligations incurred by representatives who dream of imperial power or by private bankers. Why must people suffer in order to pay private bankers' debts or to support warfare?

We can abolish public debt simply by cancelling the debt and no longer collecting it. Doing so would contribute not only to preventing large-scale wars but also to freeing societies from their subordination to the banking and financial sectors. We need to dream of another form of democracy in which diversity and multitude are not subsumed into the sameness of "the people" and in which human sociality and mutual connectedness are not turned into creditor-debtor relations.

13 Among possible radical reform programs for the current global financial crisis, we can consider the reforms suggested by economists from the Austrian school, including Ludwig von Mises, Friedrich August von Hayek, and Murray Rothbard (see Huerta de Soto 2009). This school suggests abolishing the present fractional-reserve system to prevent future financial crises. We can re-establish banks' role as a clearing of creditor-debtor relations modeled on the Bank of Amsterdam in the seventeenth century.

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